

Lessons from the last financial crisis

October 19, 2008



From left, Dale Kelberman and Peter E. Keith pose with a copy of The Sun Magazine from July 12, 1987. Kelberman and Keith appeared in that issue along with Charles O. Monk II (not pictured), for a story on the Maryland S&L crisis of the 1980s.

When the financial institutions started to fail, many blamed deregulation and greed.

Consumers panicked. Many withdrew their money, which only made things worse. The government stepped in to right the system and restore confidence.

It was May 1985, and the savings and loan panic had come to Maryland.

The crisis took years — and an army of lawyers — to resolve. Last week, attorneys involved in its aftermath spoke to The Daily Record about parallels between that financial debacle and the current one, the limits of those parallels, and what their experiences can teach those tasked with straightening out the present mess.

“It was the kind of thing that was a very small version of what’s going on here,” said Ward B. Coe III, now a partner at Gallagher, Evelius & Jones LLP.

Coe worked at Whiteford, Taylor & Preston LLP when the S&L crisis hit and helped investigate it. He was part of a special counsel’s office headed by Wilbur “Woody” Preston Jr. that spent months compiling a 457-page report on the causes of the crisis.

In the mid-1980s, the state’s savings and loan operations were still insured privately, through The Maryland Share-Savings Insurance Corp., rather than publicly. That meant that the savings and loans could offer customers more interest on their deposits than federally insured banks were allowed to pay.

The Maryland crisis was touched off by reports of management problems at Old Court Savings and Loan, which had grown rapidly by giving loans for risky real estate ventures, including some in which its executives had a stake. Perhaps primed by a savings and loan crisis in Ohio just weeks prior, accountholders at Old Court and other institutions started withdrawing their savings. Some waited in hours-long lines to do so.

Fearing a sustained run on the banks, Gov. Harry R. Hughes and legislators declared a bank holiday, capped withdrawals, passed bills to better regulate the S&L industry, and brought out-of-state banks in to buy the failing Maryland institutions.

The special counsel’s office handed out subpoenas generously, but even when bank officials

invoked their Fifth Amendment right to avoid incriminating themselves, the office was able to summons documents that revealed shady loans and self-dealing, Coe said.

A maze of bad deals

The crisis in Maryland pre-figured the national S&L failures that came later in the '80s.

It touched off legal battles that lasted for years, well into the next decade, and included civil suits and criminal charges against figures at Old Court and other institutions. The lawyers tasked with investigating the problems and prosecuting the accused discovered a maze of bad deals, shell corporations and fraudulent records, said Peter E. Keith, who worked on the prosecutions.

Bank executives misbehaved to finance a “really tacky opulent lifestyle,” including lavish parties and fancy gold carts, said Keith, now a partner at Gallagher, Evelius & Jones. Several were convicted and had to serve jail time and pay restitution.

Keith and others interviewed said some of the same factors that led to the Maryland S&L crisis of 1985 also caused the current calamity.

Dale P. Kelberman, who worked alongside Keith prosecuting bankers, said that both situations stemmed from too much exuberance, specifically about the real estate market.

In both cases, players were “banking on, if you will, the constant expectation that the real estate market was continuing to rise and it was not going to burst and the payday would be coming in the future,” said Kelberman, a partner at Miles & Stockbridge P.C.

“As the markets continue to flourish, people get a little carried away,” he added. “Prudence is kind of tossed out the window.”

Hue and cry

Keith said both crises were caused partly by toothless regulations, of savings and loans in the 1980s and investment banks in the 2000s. Where there was government oversight, it failed to keep pace with the creativity and aggressiveness of the financial sector, he said.

“That was the '80s Reagan-era free market,” Keith said. “The state regulators could not keep up with these guys.”

In the S&L collapse and the investment bank failures, the relevant industries were tasked with policing themselves, Coe added.

In both cases, the industries were way overleveraged, trying to do too much with too little capital, Keith said.

Several lawyers said that the current mess will undoubtedly spawn criminal and civil litigation. Andrew Jay Graham, who represented some of the bankers in the '80s and into the '90s, said the public and politicians today will clamor for someone to be held liable, just as they did back then.

“I guess it’s a natural reaction to want to fasten the blame on somebody other than the politicians themselves, who of course have some sort of oversight responsibility,” said Graham, a principal at Kramon & Graham P.A. “From representing several principals, it made it very difficult and in some ways unfair for those people, no matter what faults they might have had.”

“It made it very hard to get a fair shake because there was such a hue and cry for someone to pay a price,” he said.

Both crises involved massive loss of consumer confidence, Coe said.

In 1985, “literally, depositors lined up panicking in the street,” he said.

Still, today’s crisis of confidence is worse, he said.

“Here, we have a much more widespread loss of confidence and a much larger and more diverse financial system,” he said.

Different scales

Lawyers stressed that the crises are on vastly different scales. Even when the S&L scandal started affecting other states, it was contained to the U.S. Today, the global economy has led to problems in the American economy having a much broader impact.

U.S. Sen. Benjamin L. Cardin, who was speaker of the Maryland House of Delegates during the S&L crisis, said that the people affected in the ’80s were mainly those who had money in one of the affected institutions. The state’s two principal goals were to protect that money and strengthen regulations on the S&L industry.

Today, the federal government is “dealing with basically our entire economy,” Cardin said.

Paul Mark Sandler, who defended a major S&L player, also rejected the comparison.

The Shapiro, Sher, Guinot & Sandler P.A. partner acknowledged that the two crises have some things in common — dishonesty, unconventional accounting practices, lack of regulation, misused client funds — but said it is “a stretch” to draw too many parallels between the S&L scandal and today’s more complex situation.

Some lawyers offered advice for attorneys dealing with the aftermath of the current crisis.

Hughes, the former governor, urged cooperation. He never would have been able to contain the S&L mess without the help of the General Assembly, particularly Cardin, he said.

For those who end up prosecuting executives, Keith recommended focusing on “the really obvious crime, the really obvious fraudulent activity.”

Finally, Graham suggested that lawyers who go after players in the financial sector keep perspective. He cited what he considers the ’80s “failure to discriminate between the owners and executives who [have] really been doing their best and just got caught up in this avalanche of bad publicity” from those who did wrong.